

**UTAH TELECOMMUNICATION OPEN
INFRASTRUCTURE AGENCY**

FINANCIAL STATEMENTS

JUNE 30, 2005

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
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Jensen & Keddington, P.C.

Certified Public Accountants

Jeffrey B. Jensen, CPA
Gary K. Keddington, CPA
Brent E. Christensen, CPA
Jeffrey B. Hill, CPA**INDEPENDENT AUDITOR'S
REPORT**

Board of Directors
Utah Telecommunication Open Infrastructure Agency
West Valley City, Utah

We have audited the accompanying basic financial statements of Utah Telecommunication Open Infrastructure Agency (UTOPIA), as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of UTOPIA's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of UTOPIA, as of June 30, 2005, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a separate report dated September 12, 2005 on our consideration of UTOPIA's internal control over financial reporting and on our tests of compliance with certain provisions of laws and regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in conjunction with this report in considering the results of our audit.

The management's discussion and analysis is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

September 12, 2005

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY MANAGEMENT DISCUSSION AND ANALYSIS

Introduction

The following is a discussion and analysis of the Utah Telecommunication Open Infrastructure Agency (UTOPIA) financial activities for the fiscal year ending June 30, 2005.

Description of Business

Fourteen Utah cities created a separate interlocal entity to promote economic development and to improve the quality of life for their residents through the construction and operation of a wholesale, all fiber telecommunications infrastructure. The system is an open access network over which private providers of retail digital services reach customers in UTOPIA member cities.

Eleven of the current UTOPIA member cities pledged funds to provide partial loan guarantees to secure financing for the network build. Phase I of the project will deploy a network serving approximately 42,000 homes and businesses in Midvale, Murray, Lindon, Orem, Payson, and West Valley City. Phases II and III will complete the network in these cities and extend its reach into Brigham City, Centerville, Layton, Perry, and Tremonton. When completed, the network will pass in excess of 170,000 prospective subscribers.

Highlights

At the start of fiscal year 2004-2005, UTOPIA finalized arrangements to secure financing for the construction of Phase I of the network. The proceeds of this financing allowed for the settlement of deferred obligations incurred as part of the Agency's start up activities in prior years. It also allowed for the reimbursement of initial contributions made by the pledging cities that were utilized for start up expenses.

More importantly, the funds were put to work to begin construction. At the end of the fiscal year, a total of 3,045 addresses were marketable, tests of network operability had been completed, service providers had begun early marketing activities, and several hundred customers had signed up for services. Feedback from these early movers has been consistently positive. The marketing experience through the first few months of system operations and user reactions to the quality of services offered affirm expectations of take rates high enough to meet business plan objectives.

The project has overcome hurdles that caused delays in delivering marketable addresses as initially contemplated. First, acquiring sites for neighborhood electronic cabinet pads took more time than anticipated as did securing permission to attach lines to Pacific Corp utility poles. Both of these problems have now been solved and the pace of construction has accelerated. Build out of Phase I is expected to be back on schedule by the end of calendar year, 2005.

Second, arrangements for interconnection between member cities in Utah County and in Salt Lake County (a distance of about 35 miles) fell to the second and third alternative providers because of circumstances in provider organizations that were beyond UTOPIA's control. As a result, otherwise serviceable footprints in Salt Lake County were delayed in coming to market. This interconnection was completed prior to the end of the fiscal year.

Finally, UTOPIA's service providers confronted third party challenges in securing rights to distribute content and deliver advanced services. These impediments had the effect of slowing the full-scale marketing effort that the service providers planned to launch. At the close of the fiscal year, however, these challenges were about to be resolved and at the writing of this narrative are resolved.

Looking to the work scheduled for fiscal year 2005-2006, there are no significant obstacles remaining in the way of construction or marketing by all five service providers currently under contract to use the UTOPIA network—Mstar, Xmission, Veracity, SISNA, and AT&T. We expect a substantial share of the missed revenue opportunity in fiscal year 2004-2005 to be made up in subsequent periods.

It is also significant to note that costs have been within business case expectations. Construction expenses have been at, or below, projections and agency and network operation costs have also been held below budget.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY

MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Overview of Financial Statements

The financial statements included in this report have been prepared in compliance with generally accepted accounting principles. The balance sheet provides information about the Agency's resources and obligations at year end. The statement of revenues, expenses, and changes in net assets present the results of business activities during the course of the year. The statement of cash flows presents changes in cash and cash equivalents, resulting from operational and investing activities. Notes to the financial statements provide required disclosures and other information that are essential to the full understanding of material data provided in the statements. The notes present information about the Agency's accounting policies, significant account balances, obligations, commitments, contingencies and subsequent events.

The statements reflect a prior period adjustment of \$2,701,390 for consulting and feasibility studies. Given the circumstances of UTOPIA's first few years of operations, the Agency's previous auditors believed that a fair presentation of the Agency's financial position required these items to be expensed rather than capitalized. However, now that the network is in operation, the current auditors have recommended, and management agrees, that these start-up costs should be reclassified as a capital expense of building the network.

Readers of this report should keep in mind that the UTOPIA project is a very capital intensive undertaking that requires significant investment in capital assets before substantial revenues can begin to flow. The conservative business case assumed that it would take six years of full scale operations before the Phase I would become cash positive as a stand alone network. The just concluded fiscal period covered the first year of that trajectory. The time that service providers have had to actually market their services has been limited but the early indicators of market acceptance suggest that take rates and average revenue per subscriber will be higher than original business plan assumptions. As a result, management believes that the project is on a course for success, not only in terms of eventual financial self-sufficiency, but, more importantly, in terms of promoting the public policy agenda that motivated the creation of the Agency. Fiscal Year 2004-2005 marks the watershed between planning and implementation. All prior years of Agency operation were geared toward securing the wherewithal to begin.

Table 1 - Summary of the Agency's Statement of Net Assets.

	2005	2004
Current and other assets	\$ 50,612,030	\$ 143,107
Capital Assets	31,103,979	6,318
Total Assets	<u>81,716,009</u>	<u>149,425</u>
Long-term liabilities outstanding	83,770,968	660,149
Other Liabilities	6,015,250	4,097,763
Total Liabilities	<u>89,786,218</u>	<u>4,757,912</u>
Invested in net capital assets,		
Net of related debt	(512,711)	6,318
Unrestricted	<u>(7,557,498)</u>	<u>(4,614,805)</u>
Net Assets	<u>\$ (8,070,209)</u>	<u>\$ (4,608,487)</u>

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Table 2 - Summary of the Agency's Statement of Revenues, Expenses and Changes in Fund Net Assets

	2005	2004
Revenues:		
Operating revenues	\$ 123,054	\$ 30,000
Non-operating revenues		371,693
Interest income	1,273,257	255
Total Revenues	1,396,311	401,948
Expenditures:		
General and administrative	1,367,986	3,079,298
Network	2,607,386	-
Depreciation	509,732	2,001
Bond interest and fees	3,074,319	17,399
Total Expenditures	7,559,423	3,098,698
Change in net assets	(6,163,112)	(2,696,750)
Total net assets, beginning of year	(4,608,487)	(1,911,737)
Prior period adjustments	2,701,390	
Total net assets, end of year	<u>\$ (8,070,209)</u>	<u>\$ (4,608,487)</u>

Budgetary Highlights and Financial Analysis

Table 3 presents a summary view of UTOPIA's financial performance for the fiscal year 2004-2005. This presentation supplements standard financial statements to show agency budget information in a form that permits ordinary citizens to understand where the funds come from and where they go.

Variances from budget reflect substantive operational results, changes in accounting treatment of transactions, or both. The difference between budgeted and actual revenue (Line 2) is the consequence of construction and service provider marketing shifts as previously explained. Instead of applying earned interest as an offset against interest expense, Line 3 reflects an accounting determination to separately state these earnings. Since obligations were incurred in prior years, settlement of member loans (Line 4) and vendor financing repayments (except for accrued interest, Line 5) did not represent new costs for the fiscal year. The positive variance shown in Line 6 reflects the effect of accounting practice amortizing bond issuance costs over time rather than expensing them in the year of transaction (See Footnote number 5). Accounting practice also required that costs and revenues associated with the hosting of the September, 2005 Smart Community International Network conference be attributed to FY2006. For this reason, neither anticipated revenues (Line 8) nor expenditures (Line 13) are shown in this statement. The prior period adjustment explained in Footnote 11 causes the variance in Line 9.

Looking at the outflow line items, the variances reported in Lines 12, 14, 15, and 16 reflect the slow down in spending associated with construction and marketing forward shift. The variance in Line 17 derives from different treatment of the capitalized interest fund in the budget (it was included) and actual expenses (not included because it is not an expense).

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY MANAGEMENT DISCUSSION AND ANALYSIS (Continued)

Final Comment

UTOPIA member cities launched the wholesale network project to facilitate economic development and to improve the quality of life for their residents. Since construction of the network has begun, there is evidence that these objectives are being served. Business location and expansion decisions have been influenced for the benefit of UTOPIA cities by the imminent availability of world-class connectivity. Competition for customers has prompted incumbent providers to offer extraordinary values exclusively to households in UTOPIA cities. And market acceptance of the services that are available over the network is very positive. UTOPIA's Board of Directors and management will continue to work to assure that the trajectory of the project stays on track with initial projections.

Table 3 – Utah Telecommunication Open Infrastructure Agency Sources and Uses of Funds for Fiscal Year 2005.

	Prior Year FY 2004	Budget FY 2005	Actual FY 2005	Favorable (Unfavorable) Variance
1 Sources of funds				
2 Operations	\$ 30,000	\$ 2,400,635	\$ 123,054	\$ (2,277,581)
3 Interest earnings	255	-	1,273,257	1,273,257
4 Member loans	135,750	(866,351)	-	866,351
5 Supplier financing	524,399	(2,713,793)	25,718	2,739,511
6 Net bond proceeds	-	82,303,234	83,100,140	796,906
7 Assessment forfeiture	371,693			-
8 Smart Community conference		125,000		(125,000)
9 Beginning current net assets	(1,920,056)	146,136	(3,954,656)	(4,100,792)
10 Total	(857,959)	81,394,861	80,567,513	(827,348)
11 Uses of funds				
12 Agency expenses	3,081,299	1,411,056	1,367,986	43,070
13 Smart Community conference		125,000		125,000
14 Back out depreciation/amortization	(2,001)	1,609,132		1,609,132
15 Network expense	-	4,781,262	2,607,386	2,173,876
16 Capital investment	-	59,566,556	28,906,003	30,660,553
17 Debt service & reserves	17,399	13,901,855	10,092,284	3,809,571
18 Total	3,096,697	81,394,861	42,973,659	38,421,202
19 Net current assets	\$ (3,954,656)	\$ -	\$ 37,593,854	\$ 37,593,854

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF NET ASSETS
June 30, 2005

ASSETS

Current Assets

Cash		\$	182,236
Restricted investments			43,096,348
Receivables			
Miscellaneous receivables	\$	98,802	
Interest receivable - restricted investments		121,264	
Total Receivables			220,066
Prepaid expenses			110,454
Total Current Assets			43,609,104

Capital Assets

Construction in progress			18,930,249
Property and equipment-net			
Fiber optic network	12,155,022		
Office furniture and equipment	18,708		
Total Property and Equipment			12,173,730
Total Capital Assets			31,103,979

Other Assets

Restricted investments	6,988,426		
Deposit	14,500		
Total Other Assets			7,002,926

Total Assets		\$	81,716,009
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The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF NET ASSETS (Continued)
June 30, 2005

LIABILITIES

Current Liabilities

Accounts payable	\$ 37,271
Accrued liabilities	33,873
Interest payable from restricted assets	264,915
Other liabilities payable from restricted assets	4,178,382
Capital lease payable - current	1,362,929
Notes payable - current	94,200
Deferred revenue	43,680

Total Current Liabilities	6,015,250
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Non-current Liability

Notes payable	591,667
Long-term debt due in more than one year - net	83,179,301

Total Liabilities	89,786,218
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NET ASSETS

Invested in capital assets, net of related debt:	(512,711)
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Unrestricted	(7,557,498)
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Total Net Assets	(8,070,209)
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Total Liabilities and Net Assets	\$ 81,716,009
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The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
For The Year Ended June 30, 2005

Operating Revenues	
Customer access fees	\$ 80,354
Service provider fees	<u>42,700</u>
Total Operating Revenues	<u>123,054</u>
Operating Expenses	
Payroll	405,470
Material & supplies	444,703
Professional services	517,813
Network	2,607,386
Depreciation	<u>509,732</u>
Total Operating Expenses	<u>4,485,104</u>
Operating Income	<u>(4,362,050)</u>
Nonoperating Revenues (Expenses)	
Interest income	1,273,257
Bond interest and fees	<u>(3,074,319)</u>
Total Nonoperating Revenues (Expenses)	<u>(1,801,062)</u>
Change In Net Assets	(6,163,112)
Total Net Assets, Beginning of Year	(4,608,487)
Prior Period Adjustment	<u>2,701,390</u>
Total Net Assets, End of Year	<u>\$ (8,070,209)</u>

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF CASH FLOWS
For The Year Ended June 30, 2005

Operating Activities	
Cash received from customers and users	\$ 68,153
Payments to suppliers	(3,553,418)
Payments to employees	(380,645)
Net Cash From Operating Activities	<u>(3,865,910)</u>
Cash Flows From Investing Activity	
Interest Income	1,151,993
Net Cash From Investing Activity	<u>1,151,993</u>
Cash Flows From Capital and Related Financing Activities	
Purchase of property and equipment	(27,047,837)
Proceeds from issuance of bonds	85,000,000
Bond interest and fees	(2,977,159)
Cash paid for discount on bond and bond issue costs	(1,899,860)
Principal paid on capital lease	(222,603)
Deposits on leases	(14,500)
Restricted cash - net increase	(50,084,774)
Net Cash From Capital and Related Financing Activities	<u>2,753,267</u>
Net Increase (Decrease) in Cash and Cash Equivalents	39,350
Cash and Cash Equivalents, Beginning of Year	<u>142,886</u>
Cash and Cash Equivalents, End of Year	<u><u>\$ 182,236</u></u>

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
STATEMENT OF CASH FLOWS (Continued)
For The Year Ended June 30, 2005

Reconciliation of Operating Income to Net Cash from Operating Activities

Income from operations	\$ (4,362,050)
Adjustments to reconcile operating income to net cash from operating activities	
Depreciation expense	509,732
(Increase) decrease in current assets	
Accounts receivables	(98,581)
Prepaid expenses	(110,454)
Increase (decrease) in current liabilities	
Accounts payable	4,910
Accrued liabilities	(4,031,529)
Liabilities payable from restricted assets	4,178,382
Deferred revenue	43,680
Net Cash From Operating Activities	<u>\$ (3,865,910)</u>

SUPPLEMENTAL INFORMATION

Noncash Investing, Capital, and Financing Activities

Deferred bonds costs of \$79,161 were amortized to bond interest expense.

Interest expense of \$25,718 was added to the balance of notes payable.

Additions to outside plant includes \$1,585,532 financed by a capital lease.

The accompanying notes are an integral part of these financial statements.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY

NOTES TO FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF ACCOUNTING POLICIES

Reporting Entity

Utah Telecommunication Open Infrastructure Agency (UTOPIA), a separate legal entity and political subdivision of the State of Utah, was formed on March 5, 2002, by an Interlocal Cooperative Agreement pursuant to the provisions of the Utah Interlocal Cooperation Act. UTOPIA's Interlocal Cooperative Agreement has a term of fifty years. During June 2004, the Board of Directors voted to amend the interlocal agreement with the member cities to allow pledging and non-pledging members. The pledging members were required to pledge sales tax revenue from their cities to partially guarantee payment of the bonds, and in return for the pledge, they would be the first to receive UTOPIA's services. The non-pledging cities did not pledge their sales tax revenue but their cities' network will be built when financing can be arranged that does not require a loan guarantee. UTOPIA's original membership consisted of 18 founding member municipalities. As of the date of this report, there were 11 pledging members and 3 non-pledging members in UTOPIA. UTOPIA's purpose is to design, finance, build, operate, and maintain an open, wholesale, public telecommunication infrastructure that has the capacity to deliver high-speed connections to every home and business in the member communities. UTOPIA began providing services during the year, but it is still in a start-up phase. As a result, UTOPIA incurred a net loss of \$6,163,112 and has a deficit in net assets of \$8,070,209. UTOPIA is in the process of building the first part of the network.

Summary of Significant Accounting Policies

The accounting policies of UTOPIA conform to accounting principles generally accepted in the United States of America as applicable to government entities. UTOPIA has elected, under GASB Statement 20, to follow the pronouncements issued by the Financial Accounting Standards Board and Interpretations issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The following is a summary of the more significant policies.

(A) The Reporting Entity

In evaluating how to define UTOPIA for financial reporting purposes, management has considered all potential component units. The decision to include a potential component unit in the reporting entity was made by applying the criteria set forth in the related GASB pronouncement. The basic, but not the only, criterion for including a potential component unit within the reporting entity is the governing body's ability to exercise oversight responsibility. The most significant manifestation of this ability is financial interdependency. Other manifestations of the ability to exercise oversight responsibility include, but are not limited to, the selection of governing authority, the designation of management, the ability to significantly influence operations and accountability of fiscal matters. The other criterion used to evaluate potential component units for inclusion or exclusion from the reporting entity is the existence of special financing relationships, regardless of whether UTOPIA is able to exercise oversight responsibilities. Component units that do not meet the criteria for being blended into UTOPIA's financial statements are reported discretely. UTOPIA does not have any component units, nor is it a component unit of any primary government.

(B) Financial Statement Presentation and Basis of Accounting

UTOPIA prepares its financial statements on an enterprise fund basis, using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private businesses, where the intent is that all costs of providing certain goods and services to the general public be financed or recovered primarily through user charges, or where it has been deemed that periodic determination of net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 1 SUMMARY OF ACCOUNTING POLICIES (Continued)

(B) Financial Statement Presentation and Basis of Accounting (Continued)

Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations.

(C) Restricted Assets

UTOPIA maintains investments held by Wells Fargo for safekeeping of funds relating to future construction, debt service reserves and a contract with a supplier. When both restricted and unrestricted assets are available, it is UTOPIA's policy to use restricted assets first, then unrestricted assets as they are needed.

(D) Property and Equipment

Property and equipment are stated at cost, which includes capitalization of interest costs incurred during construction. Normal maintenance and repair expenses that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed asset. The net book value of property sold or otherwise disposed of is removed from the property and accumulated depreciation accounts and the resulting gain or loss is included as non-operating revenues or expenses.

Depreciation of property and equipment was computed using the straight-line method over the following estimated useful lives

Fiber optic network	6-25 years
Office furniture and equipment	5 years

(E) Retirement Plans

UTOPIA participates in two retirement plans. UTOPIA participates in a defined contribution plan and in the Utah Retirement System. Retirement plan costs are combined with employee benefits and are recorded on an accrual basis. It is UTOPIA's policy to fund the retirement plan costs as they are incurred.

(F) Cash and Cash Equivalents

All non-restricted amounts are considered to be cash and cash equivalents for cash flow statement purposes.

(G) Allowance for Doubtful Accounts

UTOPIA has not set up an allowance for doubtful accounts.

(H) Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTE 2 CASH AND INVESTMENTS

UTOPIA's deposit and investment policy is to follow the Utah Money Management Act. However, UTOPIA does not have a separate deposit or investment policy that addresses specific types of deposit and investment risks to which UTOPIA is exposed.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY **NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 2 CASH AND INVESTMENTS (Continued)

Utah State law requires that UTOPIA funds be deposited with a "qualified depository" as defined by the Utah Money Management Act. "Qualified depository" includes any depository institution which has been certified by the Utah State Commissioner of Financial Institutions as having met the requirements as defined in Rule 11 of the Utah Money Management Act. Rule 11 establishes the formula for determining the amount of public funds which a qualified depository may hold in order to minimize risk of loss and defines capital requirements which an institution must maintain to be eligible to accept public funds.

The Utah Money Management Act also governs the scope of securities allowed as appropriate temporary investments for UTOPIA and conditions for making investment transactions. Investment transactions are to be conducted through qualified depositories or primary reporting dealers.

As of June 30, 2005, UTOPIA had the following deposits and investments:

<u>Deposit and investment type</u>	<u>Fair Value</u>
Cash on deposit	\$ 197,770
Investments in money market funds	50,084,774
	<u>\$ 50,282,544</u>

Cash on Deposit:

Custodial credit risk – deposits. In the case of deposits, this is the risk that in the event of a bank failure, UTOPIA's deposits may not be returned to it. As of June 30, 2005, \$97,770 of the \$197,770 balance of deposits was exposed to custodial credit risk because it was uninsured and uncollateralized. UTOPIA has no policy to manage this type of risk.

Investment in money market funds:

Interest rate risk. The risk that changes in the interest rate will have an adverse affect on the fair value of an investment. UTOPIA's investment in money market funds are not subject to interest rate risk.

Credit risk. This is the risk that an issuer or other counter party to an investment will not fulfill its obligations. As of June 30, 2005 the money market funds in which UTOPIA has investments were unrated.

Concentration of Credit Risk. This is the risk of loss attributable to the magnitude of UTOPIA's investment in a single issuer. UTOPIA's investment in money market funds is not subject to a concentration of credit risk.

Custodial credit risk – investments. This is the risk that, in the event of the failure if the counterparty to a transaction, UTOPIA will not be able to recover the value of its investments that are in the possession of an outside party. UTOPIA's investment in money market funds has no custodial credit risk.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 2 CASH AND INVESTMENTS (Continued)

Investment in money market funds (Continued):

Components of cash and investments (including interest earning deposits) at June 30, 2005, are as follows:

Cash on hand and on deposit:

Cash on hand	\$ 300
Cash on deposit	181,936
Investments in money market funds	<u>50,084,774</u>
Total cash and investments	<u>\$ 50,267,010</u>

Cash and investments are included in the accompanying combined statement of net assets as follows:

Cash	\$ 182,236
Restricted investments	<u>50,084,774</u>
Total cash and investments	<u>\$ 50,267,010</u>

NOTE 3 RESTRICTED ASSETS

Restricted assets consist of investments consist of the following:

Future constructions costs	\$ 37,827,343
Future interest payments on bonds	5,269,005
Required debt reserves	6,500,000
Restricted by contract with supplier	<u>488,426</u>
	<u>\$ 50,084,774</u>

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 4 PROPERTY AND EQUIPMENT

The following summarizes UTOPIA's property and equipment as of June 30, 2005:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets not being depreciated				
Construction in Progress	\$	\$ 18,930,249	\$	\$ 18,930,249
Total Capital Assets not being depreciated	0	18,930,249	0	18,930,249
Other Capital Assets				
Outside Plant	4,115	4,288,016		4,292,131
Inside Plant		7,144,074		7,144,074
Customer Premise Equipment		1,225,331		1,225,331
Office Furniture and Equipment	5,182	19,723		24,905
Total Other Capital Assets at historical cost	9,297	12,677,144	0	12,686,441
Less Accumulated Depreciation				
Outside Plant	(388)	(59,354)		(59,742)
Inside Plant		(406,743)		(406,743)
Customer Premise Equipment		(40,029)		(40,029)
Office Furniture and Equipment	(2,591)	(3,606)		(6,197)
Total Accumulated Depreciation	(2,979)	(509,732)	0	(512,711)
Other Capital Assets, Net	6,318	12,167,412	0	12,173,730
Property and Equipment, Net	\$ 6,318	\$ 31,097,661	\$ 0	\$ 31,103,979

Depreciation expense of \$509,732 was charged to operating expense for the year ended June 30, 2005. During the year, UTOPIA incurred interest expense of \$2,532,542 of which \$272,634 was capitalized and is included in construction in progress.

NOTE 5 LONG-TERM DEBT

The following is a summary of the changes in long-term debt obligations for the year ended June 30, 2005.

	Beginning Balance	Additions	Reductions	Ending Balance	Due Within One Year
Revenue Bonds					
2004 Revenue bond	\$ 0	\$ 85,000,000	\$	\$ 85,000,000	\$ 0
Less unamortized issuance costs		(1,899,860)	79,161	(1,820,699)	
Total revenue bonds	0	83,100,140	79,161	83,179,301	0
Capital lease		1,585,532	(222,603)	1,362,929	1,362,929
Notes payable	660,149	25,718		685,867	94,200
Total Long-Term Debt	\$ 660,149	\$ 84,711,390	\$ (143,442)	\$ 85,228,097	\$ 1,457,129

During the year UTOPIA issued Revenue Bonds. The revenues of UTOPIA are pledged to pay the debt service on the revenue bonds. Interest on these bonds is payable in semiannually at varying interest rates ranging from 2.50% to 5.75%. The rates vary such that the bonds may be remarketed at a price equal to the principal amount plus accrued interest. The revenue bonds mature on July 1, 2026. The following summarizes UTOPIA's revenue bonds debt service requirements as of June 30, 2005.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 5 LONG-TERM DEBT (Continued)

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ -	\$ 2,762,500	\$ 2,762,500
2007	700,000	2,054,813	2,754,813
2008	1,700,000	2,699,938	4,399,938
2009	1,800,000	2,651,188	4,451,188
2010	2,400,000	2,579,688	4,979,688
2011-2015	19,400,000	10,262,688	29,662,688
2016-2020	26,000,000	7,849,563	
2021-2025	30,650,000	3,052,156	
2026-2027	2,350,000	81,656	
	<u>85,000,000</u>	<u>\$ 33,994,188</u>	<u>\$ 49,010,813</u>
Less unamortized cost of issuance	<u>(1,820,699)</u>		
Total	<u>\$ 83,179,301</u>		

Capital Lease

UTOPIA is obligated under a lease for the use of a fiber optic network from Murray City, a member city. Because the terms and options contained in the lease have effectively created a financing arrangement, UTOPIA is required to record this transaction as a capital lease. Lease payments are \$250,000 each year including imputed interest at 3.25%, unless additional funding is obtained, in which case, the total amount of \$1,402,491 will be paid in 2006. The capitalized cost of the fiber optic network was \$1,585,532. Amortization of \$24,666 was included in amounts reported as depreciation. Management anticipates exercising the purchase option during the next fiscal year.

Minimum lease payments for the years ending June 30 are as follows:

2006	\$ 1,402,491
Less amounts representing interest	<u>(39,562)</u>
Present value of future minimum lease payments	<u>\$ 1,362,929</u>

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY **NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 5 LONG-TERM DEBT (Continued)

The notes payable consists of the following:

Amounts owed to non-pledging members. These amounts will be paid when UTOPIA begins to build the network in the respective member's city. Management does not anticipate making any payments in the next fiscal year.

\$ 135,750

Note payable due to DynamicCity. Payment by UTOPIA is contingent upon UTOPIA having paid all other then current debts due to DynamicCity. The balance includes accrued interest at 7.25%. Management does not anticipate making any payments in the next fiscal year.

393,117

Amounts due to DynamicCity for services rendered prior to UTOPIA issuing bonds. By contract, DynamicCity agreed to defer payment on 30% and 20% of the original balance of \$314,000 until UTOPIA issues its 2nd and 3rd bonds respectively. Management anticipates issuing its 2nd bond during the next fiscal year. Therefore, \$94,200 of this balance is considered current.

157,000

685,867

Less current portion

(94,200)

\$ 591,667

NOTE 6 PENSION PLAN

Plan Description

UTOPIA contributes to the Local Governmental Noncontributory Retirement System which is a cost sharing multiple-employer defined benefit pension plan administered by the Utah Retirement Systems (Systems). The Systems provide refunds, retirement benefits, annual cost of living adjustment and death benefits to plan members and beneficiaries in accordance with retirement statutes.

The Systems are established and governed by the respective sections of Chapter 49 of the Utah Code Annotated 1953 as amended. The Utah Retirement Office Act in Chapter 49 provides for the administration of the Utah Retirement Systems and Plans under the direction of the Utah State Retirement Board (Board) whose members are appointed by the Governor. The Systems issue a publicly available financial report that includes financial statements and required supplementary information for the State and School Contributory Retirement System and State and School Noncontributory Retirement System. A copy of the report may be obtained by writing to the Utah Retirement Systems, 540 East 200 South, Salt Lake City, Utah 84102 or by calling 1-800-365-8772.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY **NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 6 PENSION PLAN (Continued)

Funding Policy

Plan members are required to contribute a percent of their covered salary (all or part may be paid by the employer) to the respective systems to which they belong. UTOPIA is required to contribute 11.09% of the covered salary to the Noncontributory System. The contribution rates are the actuarially determined rates. The contribution requirements of the Systems are authorized by statute and specified by the Board.

UTOPIA's contribution to the Noncontributory System for the years ending June 30, 2005, 2004 and 2003 were \$14,817, \$4,518 and \$1,923 respectively. The contributions were equal to the required contributions for each year.

UTOPIA is legally obligated to contribute to the retirement systems as long as they have employees meeting membership requirements.

UTOPIA contributes to a non-contributory defined contribution retirement benefit plan covering substantially all employees. Currently all of the assets and income of the 457 Plan are held in trust by the plan administrator for the exclusive benefit of the participants or their beneficiaries rather than as assets of UTOPIA. Employer contributions under this plan during the years ended June 30, 2005, 2004 and 2003, were \$32,132, \$21,393 and \$6,169 respectively.

NOTE 7 OPERATING LEASE

UTOPIA has entered into various operating leases to secure network operations facilities, office space and equipment. The current year's rental expense was \$174,220. These leases range from 3 years to 15 years, with renewal options up to 20 years. Total remaining minimum lease payments at June 30, 2005 are as follows:

2006	\$	466,155
2007		472,955
2008		347,545
2009		211,495
2010		218,362
Thereafter		<u>1,038,850</u>
	\$	<u><u>2,755,362</u></u>

NOTE 8 COMMITMENTS AND CONTRACTS

UTOPIA entered into various contracts with contractors, vendors and suppliers to provide the construction and equipment needed for the network.

In conjunction with the revenue bonds issued during the year, UTOPIA was required to obtain a letter of credit. If UTOPIA fails to pay the bonds, the letter of credit will be used to pay the bonds. UTOPIA pays an annual fee for this line of credit.

Contract with DynamicCity

During 2002 UTOPIA entered into a contract with DynamicCity to manage the construction of the fiber optic network. DynamicCity has agreed to defer certain portions of the payments owed to them from UTOPIA.

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)**

NOTE 8 COMMITMENTS AND CONTRACTS (Continued)

Contract with DynamicCity (Continued)

DynamicCity has agreed to pay UTOPIA a royalty based on DynamicCity's gross revenues from intellectual property developed while designing UTOPIA's fiber optic network. Each year DynamicCity will pay 1% of their gross revenues to UTOPIA until UTOPIA has received \$1,000,000 during that year. At that point, DynamicCity will pay UTOPIA 2% of gross revenues until UTOPIA has received \$12,000,000 during that year. During the year ending June 30, 2005 DynamicCity did not have any of this type of gross revenues. As a result, UTOPIA did not receive any royalty payments.

UTOPIA has agreed to pay DynamicCity 10% of UTOPIA's Adjusted Net Income for 20 years beginning July 2004. If DynamicCity meets certain performance criteria, UTOPIA agreed to pay DynamicCity an additional 10% of UTOPIA's Adjusted Net Income for 20 years beginning July 2004.

If DynamicCity does not meet the performance criteria for a given year or month, UTOPIA is not obligated to pay the additional 10% of Adjusted Net Income for that year or month. DynamicCity has agreed to defer receipt of these payments of Adjusted Net Income, if the payment would cause UTOPIA to fail to meet any debt service requirements related to building the network. If UTOPIA needs to defer these payments, DynamicCity can net them against payment of royalties to UTOPIA. For the year ending June 30, 2005 UTOPIA did not have Adjusted Net Income, as described in the contract.

DynamicCity has also agreed to make an operating loan and a line of credit available to UTOPIA.

NOTE 9 PLEDGING MEMBERS LIABILITY

The 11 Pledging Member's of UTOPIA have pledged sales and use tax revenues to partially guarantee payment of UTOPIA's Revenue bonds. In return for the pledge, these members will be among the first cities to receive UTOPIA's services. In July 2004 UTOPIA issued an \$85,000,000 revenue bond. The first four years of bond payments will be made from a debt reserve fund, funded by the debt. From that point on, until the bonds are due in July 2026, net revenues from UTOPIA will reimburse the debt service fund for payments on the bond debt. To the extent that there are insufficient net revenues to pay the debt service, the 11 Pledging Members are required to reimburse the UTOPIA debt service fund of any shortfall by their respective percentages of ownership up to a specific dollar amount. The Pledging Member's percentage of the Debt Service Reserve shortfall is listed below, with a corresponding annual maximum liability. Any amounts paid by Pledging Members to UTOPIA to reimburse the debt service fund will be a loan to be repaid by UTOPIA.

On July 1, 2007, the Pledging Member's will be required to deposit the amounts specified below into the UTOPIA Series 2004 Bond Debt Service Reserve Fund. These funds will remain on deposit until the sooner of the bonds being retired or 20 years from July 1, 2007. To the extent that the initial projects operate profitably, UTOPIA has plans on issuing a total of \$340,000,000 in bonds. Any bonds or debt issued or incurred by UTOPIA will not constitute debt of the Pledging Members.

UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
NOTES TO FINANCIAL STATEMENTS (Continued)

NOTE 9 PLEDGING MEMBERS LIABILITY (Continued)

<u>Pledging Member</u>	<u>Share of Total Pledge</u>	<u>Due On July 1, 2007 On Phase I Financing</u>	<u>Due On July 1, 2007 On Subsequent Financing</u>	<u>Maximum Pledge *</u>
Brigham City	3.33%	\$ 67,191	\$ 268,765	\$ 335,956
Centerville	3.31%	66,825	267,301	334,126
Layton	16.62%	335,394	1,341,574	1,676,968
Lindon	3.06%	308,681	-	308,681
Midvale	6.03%	608,337	-	608,337
Murray	12.24%	1,235,039	-	1,235,039
Orem	21.70%	2,189,704	-	2,189,704
Payson	2.58%	259,920	-	259,920
Perry	0.82%	16,483	65,931	82,414
Tremonton	2.51%	50,695	202,779	253,474
West Valley City	27.82%	2,806,999	-	2,806,999
	<u>100.00%</u>	<u>\$ 7,945,268</u>	<u>\$ 2,146,350</u>	<u>\$ 10,091,618</u>

* = These amounts are also the annual maximum debt service that can be required of the Pledging Members.

NOTE 10 SMART COMMUNITY CONFERENCE

UTOPIA put on a Smart Community Conference after year end. Portions of the expenses and revenues related to that conference were incurred or received prior to year end. Expenses of \$86,854 related to the conference have been included in prepaid expenses. Revenues of \$43,680 related to the conference have been included in accounts receivable and deferred revenue.

NOTE 11 SUBSEQUENT EVENTS

Subsequent to year end, UTOPIA entered into various contracts with contractors, vendors and suppliers to provide the construction and equipment needed for the network.

NOTE 12 PRIOR PERIOD ADJUSTMENT

Management determined that \$2,701,390 of engineering and other costs incurred to build the fiber optic network, which were expensed in prior years, should have been capitalized. The beginning balances of Unrestricted Net Assets has been increased by \$2,701,390. The adjustment had no effect on the change in net assets for 2005.

**UTAH TELECOMMUNICATION OPEN
INFRASTRUCTURE AGENCY**

SUPPLEMENTARY REPORTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2005

**UTAH TELECOMMUNICATION OPEN INFRASTRUCTURE AGENCY
SUPPLEMENTARY REPORTS**

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Jensen & Keddington, P.C.

Certified Public Accountants

Jeffrey B. Jensen, CPA
Gary K. Keddington, CPA
Brent E. Christensen, CPA
Jeffrey B. Hill, CPA

**REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON
COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT
OF FINANCIAL STATEMENTS
PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS**

Board of Directors
Utah Telecommunication Open Infrastructure Agency
West Valley City, Utah

We have audited the financial statements of Utah Telecommunication Open Infrastructure Agency (UTOPIA), as of and for the year ended June 30, 2005, and have issued our report thereon dated September 12, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered UTOPIA's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether UTOPIA's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants agreements, noncompliance with which could have a direct and material effect on the determination of financial statements amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Jensen & Keddington

September 12, 2005



Jensen & Keddington, P.C.

Certified Public Accountants

Jeffrey B. Jensen, CPA
Gary K. Keddington, CPA
Brent E. Christensen, CPA
Jeffrey B. Hill, CPA**INDEPENDENT AUDITOR'S REPORT
ON STATE OF UTAH
LEGAL COMPLIANCE**

Board of Directors
Utah Telecommunication Open Infrastructure Agency
West Valley City, Utah

We have audited the financial statements of Utah Telecommunication Open Infrastructure Agency (UTOPIA), for the year ended June 30, 2005 and have issued our report thereon dated September 12, 2005. Our audit also included testwork on UTOPIA's compliance with the following general compliance requirements identified in the *State of Utah Legal Compliance Audit Guide*:

Cash Management
Other General Compliance Issues

UTOPIA did not receive any major or nonmajor grants during the year ended June 30, 2005.

The management of UTOPIA is responsible for UTOPIA's compliance with all compliance requirements identified above. Our responsibility is to express an opinion on compliance with those requirements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether material noncompliance with the requirements referred to above occurred. An audit includes examining, on a test basis, evidence about UTOPIA's compliance with those requirements. We believe that our audit provides a reasonable basis for our opinion.

The results of our audit procedures disclosed no instances of noncompliance with the requirements referred to above.

In our opinion, UTOPIA complied, in all material respects, with the general compliance requirements identified above for the year ended June 30, 2005.

Jensen & Keddington

September 12, 2005